



M e m o r a n d u m

To: Panel Members

Date: October 24, 2002

From: Peter McNamee, Executive Director

File: bqut.tips

Subject: SERVICE CHARGES/BANQUET TIPS AS WAGES

This memorandum addresses the issue of service charges and banquet tips raised at the July 2002 Panel meeting. As you recall, Panel members requested information on restaurant service charges and banquet tips, in order to determine if these types of remuneration should be allowed to supplement a trainee's base wage to meet the Employment Training Panel's (ETP) minimum wage requirements. Following is a summary of the treatment of service charges and banquet tips by three control agencies: the Internal Revenue Service, the California State Board of Equalization; and the California State Labor Standards Enforcement:

- The Internal Revenue Service holds that banquet tips paid directly to an employer and then turned over to the employee are always considered service charges and *must be treated as wages*.
- The California State Board of Equalization views banquet tips as either *mandatory* (in which case they are considered service charges and are subject to sales tax) or *voluntary* (in which case they are considered tips and not subject to sales tax).
- The California Division of Labor Standards Enforcement holds that if a banquet service charge is voluntary (and hence exempt from sales tax), then it is considered a tip and is the property of the employee or employees involved in the event. In contrast, if a service charge is mandatory, then it is regarded as part of the employer's gross receipts (and therefore subject to sales tax) and not as a tip.

In summary, *mandatory* service charges are: (1) compulsory charges that must be paid (in addition to regular charges) by a customer directly to an establishment; (2) subject to sales tax; (3) distributed by the employer to the employee; and, (4) considered wages for federal employment tax purposes and for income tax withholding.

In contrast, *voluntary* gratuities are: (1) optional tips; (2) paid directly to an employee; and, (3) exempt from sales tax. Since *mandatory* service charges/banquet tips are considered wages, it is reasonable that the Panel allow such charges to be used to supplement an employee's base wage for the purpose of meeting ETP minimum wage requirements.

Recommendation: That the Panel allow the use of mandatory service charges/banquet tips to supplement a trainee's base wage for the purpose of meeting ETP's minimum wage requirements.